

STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2765

AUDIT REPORT
OF
INTELENET COMMISSION
STATE OF INDIANA
July 1, 2001 to June 30, 2003



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AGENCY OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Executive Director	Mr. Jerry E. Sullivan	01-13-01 to 12-02-03
Acting Executive Director	Mr. Kent Champagne	12-03-03 to 01-10-05
Chairman of Commission	Mr. Stanley G. Jones	12-12-95 to 06-30-04



STATE OF INDIANA

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STATE BOARD OF ACCOUNTS
302 WEST WASHINGTON STREET
ROOM E418
INDIANAPOLIS, INDIANA 46204-2765

Telephone: (317) 232-2513
Fax: (317) 232-4711
Web Site: www.in.gov/sboa

INDEPENDENT AUDITOR'S REPORT

TO: THE OFFICIALS OF INTELENET COMMISSION

We have audited the accompanying basic financial statements of the Intelenet Commission as of and for the years ended June 30, 2002 and 2003, as listed in the table of contents. These financial statements are the responsibility of the agency's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Intelenet Commission as of June 30, 2002 and 2003, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of required supplementary information. However, we did not audit the information and express no opinion on it.

STATE BOARD OF ACCOUNTS

January 6, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Intelenet's annual financial report presents an overview of the Intelenet Commission and discussion and analysis of the Intelenet's financial performance for the year ended June 30, 2003. Please read it in conjunction with the Intelenet's financial statements, which follow this section.

OVERVIEW OF THE INTELENET COMMISSION

OVERVIEW OF THE FINANCIAL STATEMENTS

This financial report consists of three parts: management's discussion and analysis (this section), the basic financial statements, and the notes to the financial statements.

Intelenet's financial statements are prepared on an accrual basis in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. Under this basis of accounting, revenues are recognized in the period in which they are earned, expenses are recognized in the period in which they are incurred, and depreciation of assets is recognized in the Statements of Revenues, Expenses, and Changes in Net Assets. All assets and liabilities associated with the operation of the Intelenet Commission are included in the Statement of Net Assets.

The financial statements provide both long and short-term information about Intelenet's overall financial status. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

FINANCIAL HIGHLIGHTS

Intelenet's net assets increased by \$1,302,000 resulting primarily from the continued increase in the Indiana Telecommunications Network services to state agencies, K-12 school corporations, public libraries and other authorized users now totaling 1,800 sites. ITN Operating Revenues increased to \$18,769,500, with the corresponding ITN Costs totaling \$11,531,600 for Fiscal Year 2003.

Access Indiana Gateway Services gross revenues increased to \$19,427,800 and A.I. Net Revenues totaled \$348,400 for Fiscal Year 2003. Intelenet's customers took advantage of the steadily increasing depth of available Access Indiana on-line transactional services throughout the year.

Intelenet Commission's Operating Expenses for Fiscal Year 2003 totaled \$2,251,800, a slight decrease from the prior fiscal year's total of \$2,318,300.

Interest Income from Intelenet's investments of K-12 school corporation and public libraries state grant funds and USF funds totaled \$175,800 for Fiscal Year 2003, decreasing from the prior year's total of \$331,300 and reflecting the overall decline in interest rates during the year.

2004 Outlook: Certain factors that may affect future results:

Outlook: Certain factors that may affect future results:

The Intelenet Commission has lowered ITN monthly service prices effective with the beginning of Fiscal Year 2004. These price changes are projected to reduce net income by approximately \$100,000 per month. It is anticipated that the revenue decrease is manageable, given the continuance of the present level of customer penetration.

Intelenet, together with its ITN network manager, IHETS will be positioning newer technology telecommunication equipment (primarily routers) at customers' premises during Fiscal Year 2004 to support digital video transmissions over the network using Internet protocol.

The Intelenet Commission anticipates receiving state government grant funds for its K-12 school corporation and public library customers during early Fiscal Year 2004. These funds, together with USF discounts, enable Intelenet to pay a substantial portion or all of the monthly service costs for those customer groups network services (typically a single T-1 circuit). If those grant funds aren't forthcoming or arrive later on in the fiscal year, the Intelenet Commission may be required to initiate service billings directly to the customers for the portion of the price not covered by such grant funds. Such action may result in some decrease in the customer base.

Financial Projections:

Summary level financial projections for Fiscal Year 2004 is as follows:

Total Operating Revenues	\$45,516,800
Total Cost of Sales	\$39,687,600
Gross Income	\$5,829,200
Operating Expenses	\$2,464,600
Interest Income	\$108,000
Net Income	\$3,472,600

FINANCIAL ANALYSIS

Net Assets

Intelenet's total assets at June 30, 2003 were approximately \$20,160,000 compared to \$21,163,000 for the prior year.

Table 1 - Net Assets

	<u>2003</u>	<u>2002</u>
<u>Assets</u>		
Cash and Cash Equivalents	\$ 12,334,641	16,067,017
Accounts Receivable and Other Assets	5,997,176	3,109,983
Capital Assets, Net	<u>1,827,431</u>	<u>1,986,229</u>
Total Assets	<u><u>20,159,248</u></u>	<u><u>21,163,229</u></u>
<u>Liabilities and Net Assets</u>		
<u>Liabilities:</u>		
Accounts Payable and Accrued Expenses	4,969,120	5,210,518
Deferred Income	2,955,909	3,885,806
Loans and Capital Leases Payable	<u>1,026,303</u>	<u>2,161,159</u>
Total Liabilities	<u><u>8,951,332</u></u>	<u><u>11,257,483</u></u>
<u>Net Assets</u>		
Restricted	6,400,659	10,276,762
Unrestricted (deficit)	4,006,129	(646,086)
Invested in capital assets, net of related debt	<u>801,128</u>	<u>275,070</u>
Total Net Assets	<u><u>11,207,916</u></u>	<u><u>9,905,746</u></u>
Total Liabilities and Net Assets	<u><u>\$ 20,159,248</u></u>	<u><u>\$ 21,163,229</u></u>

Current Assets

Intelnet's Cash and Cash Equivalents totaled \$12,334,600 at the end of Fiscal Year 2003. This amount included \$6,500,000 in certificates of deposit and money market certificates held in Fifth Third Bank, Old National Bank and First Internet Bank of Indiana. This amount was sizably reduced from the prior year's total of \$16,067,000 due to delays in receiving USF funds for the current fiscal year, which weren't approved for disbursement by the FCC's USF funds administrator, Schools and Libraries Division, until March 2003. This increased the USF Receivables to \$2,973,400 at the end of Fiscal Year 2003, up from the prior year's total of \$42,000. Accounts Receivable, other than USF Receivables, totaled \$2,814,000 at the end of Fiscal Year 2003, down slightly from the prior fiscal year's total of \$2,923,000.

Capital Assets

The Intelnet Commission's Capital Assets as of the end of Fiscal Year 2003, net of Accumulated Depreciation, totaled \$1,827,400 as compared to Fiscal Year 2002's net capital assets total of \$1,986,200. During Fiscal Year 2003 acquired some Cisco switching equipment used in the ITN network services through an early buyout of capital leases held by Cisco Systems Capital Corp. The remaining capital leased assets as of the end of Fiscal Year 2003, net of accumulated depreciation, totaled \$1,212,700.

Current Liabilities

Accounts Payables for Fiscal Year 2003 totaled \$1,235,200, down from the prior fiscal year's total of \$3,252,900.

During Fiscal Year 2003, the Intelenet Commission completely paid off a \$450,000 loan from the Indiana Higher Education Telecommunication System (IHETS).

USF Discounts Payable to K-12 school corporations and public libraries as of the end of Fiscal Year 2003 totaled \$3,261,200 versus \$1,518,400 in the prior year due to delays in receiving USF funds.

Deferred Income/Long Term Liabilities

The Indiana Department of Administration, Division of Information Technology (DoIT) prepayments for ITN services as of the end of Fiscal Year 2003 totaled \$2,796,300 as compared to the prior fiscal year's total of \$3,574,100.

Capital Lease payables as of the end of the current fiscal year totaled \$1,026,300, which reflected principal payments on capital leases.

Other Deferred Income and Agency Accounts totaled \$160,700 and \$321,5880, respectively as of the end of Fiscal Year 2003, which was comparable to the prior year.

Restricted Funds

The Intelenet Commission continued to hold state grant funds for the K-12 school corporations and public libraries totaling \$5,754,700 as of the end of the fiscal year. However, the state grant funds held for the public libraries have been essentially depleted.

Net Assets

Intelenet's total net assets as of the end of Fiscal Year 2003 totaled \$11,207,900 as compared to the prior fiscal year's total of \$9,905,700. The primary change was the result of ITN revenue growth.

Unrestricted funds held by the Intelenet Commission as of the end of Fiscal Year 2003 totaled a positive \$2,662,100 as compared to Fiscal Year 2002's total deficit \$646,100.

Changes in Net Assets

The following table shows the changes in net assets for the years ended June 30, 2003 and 2002.

Intelenet Commission
Statement of Revenues, Expenses and Changes in Net Assets (Unaudited)
Years ended June 30, 2003 and 2002

Table 2 - Changes in Net Assets

	<u>2003</u>	<u>2002</u>	<u>\$ Change</u>
<u>Revenue</u>			
Accesss Indiana - Information	\$ 19,427,787	\$ 17,367,412	\$ 2,060,375
Indiana Telecommunications Network	18,769,532	11,106,894	7,662,638
USF Revenues	5,167,934	1,533,191	3,634,743
Grant Revenues	3,416,936	3,500,000	(83,064)
Interest Revenue	175,755	331,298	(155,543)
Other Revenues	2,827,461	3,957,744	(1,130,283)
Total Revenues	<u>49,785,405</u>	<u>37,796,539</u>	<u>11,988,866</u>
<u>Cost of Sales</u>			
Accesss Indiana - Information	19,079,422	17,823,728	1,255,694
Indiana Telecommunications Network	11,531,355	4,276,122	7,255,233
USF Expenses	5,167,934	2,239,266	2,928,668
Grant Expense - Connect 2000	7,429,421	4,331,690	3,097,731
Other Expenses	3,023,281	3,472,071	(448,790)
Total Cost of Sales	<u>46,231,413</u>	<u>32,142,877</u>	<u>14,088,536</u>
Gross Income	<u>3,553,992</u>	<u>5,653,662</u>	<u>(2,099,670)</u>
<u>Expenses</u>			
Salaries and Benefits	1,607,391	1,597,279	10,112
Salaries	1,216,568	1,193,728.00	22,840
Employer Taxes and Benefits	390,823	403,551.00	(12,728)
Professional Services	285,197	309,349.00	(24,152)
Other Operating Expenses	359,234	411,637	(52,403)
Total Expenses	<u>2,251,822</u>	<u>2,318,265</u>	<u>(66,443)</u>
Change in Net Assets	1,302,170	3,335,397	(2,033,227)
Beginning Net Assets (As Restated, 2002)	<u>9,905,746</u>	<u>6,570,349</u>	<u>3,335,397</u>
Ending Net Assets	<u>\$ 11,207,916</u>	<u>\$ 9,905,746</u>	<u>\$ 1,302,170</u>

Total operating revenues for Fiscal Year 2003 totaled \$49,609,700 as compared to \$37,465,200 for Fiscal Year 2002. The Indiana Telecommunication Network (ITN) Revenues for Fiscal Year 2003 totaled \$18,769,500 as compared to the prior year's total of \$11,106,900. Fiscal Year 2003 was the first full year that Intelenet's financials reflected the total ITN operations including operating revenues and corresponding cost of sales. ITN provided high capacity network services to Intelenet's public sector customers at approximately 1,800 sites statewide as of the end of the fiscal year.

Access Indiana Gateway Service Revenues totaled \$19,427,800 for Fiscal Year 2003. Of this gross revenue total, the Intelenet Commission receives 2%, equating to \$380,900 as a contract management fee. Access Indiana provides its gateway (website-based) services predominantly free to the citizens of the state. Commercial customers access certain records electronically and pay convenience fees to Access Indiana. These services are funded without taxes.

Data Revenues for Fiscal Year 2003 totaled \$472,100 and consisted primarily of ongoing revenues for five DS-3 (45 Mbps) circuits connecting several of Indiana University's campuses. Grant Revenues consists of one state grant from the Indiana State Library, for \$3,416,900. Intelenet received no state grants on behalf of K-12 school corporations during Fiscal Year 2003. WAN Service revenues of \$457,900 for Fiscal Year 2003 were for overall administrative services provided by Intelenet for the state agencies WAN.

Long Distance Service Revenues of \$245,500 for Fiscal Year 2003 were down slightly from the prior year's total of \$263,300 and reflects the lower prices available from Qwest during the year. A smaller number of Intelenet's customers continue to be provided service from AT&T.

Cost of Sales

Cost of Sales for Fiscal Year 2003 totaled \$46,231,400 as compared to the prior fiscal year's total of \$32,142,900. Again, Fiscal Year 2003 was the first full year that ITN's business costs, lease equipment costs and interest were included on Intelenet's books of account. The ITN Costs for Fiscal Year 2003 totaled \$16,953,800 for related business cost of sales, \$797,200 for capital lease cash outlay and \$68,300 for interest expense on those leases.

During Fiscal Year 2003, grant expenses of \$7,429,400 were distributed on behalf of the state's K-12 school corporations and public libraries. Lease Line Costs of \$153,300 were for the provision of dedicated circuits for Project Hoosier Safe T, provided to state agencies separately from ITN services. Also during Fiscal Year 2003, the Intelenet Commission began offering specialized network consulting services (additional value added services) to certain of its public sector customers to enhance the utilization of network services provided. Technical Consulting costs were incurred from contracted resources assisting in this new service offering.

Gross Income

Gross Income for Fiscal Year 2003 from operations, consisting of operating revenues less direct cost of sales, totaled \$3,378,200 as compared to Fiscal Year 2002's total of \$5,322,400. FY 2003's Gross Income equaled approximately 6.8% % of total operating revenues.

Operating Expenses

Fiscal Year 2003 Operating Expenses were \$2,251,800 as compared to the prior fiscal year's total of \$2,318,300. Salaries, taxes and benefits costs totaled \$1,607,400 increasing less than 1% from Fiscal Year 2002's total of \$1,597,300. Professional Services total of \$285,200 also decreased slightly from the prior year's total of \$309,300.

Other Income

The Intelenet Commission earned interest on certificates of deposit, money market certificates and a sweep account during Fiscal Year 2003, totaling \$175,800. This total was down markedly from the prior year's total of \$331,300 primarily due to the decline in interest rates and the reduced amount of state grant funds and USF funds held by Intelenet during the fiscal year.

Net Income

Intelenet's Net Income for Fiscal Year 2003 totaled \$1,302,170, down from the prior fiscal year's total of \$3,666,700. Net Income equaled 2.6% of Total Operating Revenues. The primary difference was the timing of grant and USF revenues and expenses.

Capital Assets and Debt Administration

Capital Assets

Intelenet's capital assets consist primarily of equipment and infrastructure costs to support technology services. As of June 30, 2003, Intelenet had invested \$7,189,000 in capital assets that have a remaining depreciated value of \$1, 827,400. As compared to the prior year, this amount represents a decrease (including additions and disposals) of \$158,800. The Intelenet Commission invested in equipment and software to enhance the Indiana Telecommunications Network during Fiscal Year 2003. Intelenet invested \$394,000 in Sniffer Pro Network Monitoring equipment and software; and, \$219,200 in an Accord Bridge (equipment and software) utilized to manage concurrent videoconferencing sessions over the network.

Debt Administration

On occasion, Intelenet enters into capital lease agreements to finance the purchase of capital assets or borrows money from related parties for short term financing of new services. At June 30, 2003 and 2002, Intelenet had an outstanding capital lease liability of \$1,026,300 and \$1,711,200. At June 30, 2003 and 2002, outstanding loans payable were \$0 and \$450,000.

Intelenet Commission
Statements of Net Assets - Business Type Activities
June 30, 2002 and 2003

<u>Assets</u>	<u>2002</u>	<u>2003</u>
Cash and Cash Equivalents	\$ 16,067,017	\$ 12,334,641
Accounts Receivable	2,922,956	2,813,995
Accounts Receivable - USF	41,963	2,973,423
Prepaid Expenses	145,064	209,758
Capital Assets	6,219,692	7,189,000
Less: Accumulated Depreciation	<u>(4,233,463)</u>	<u>(5,361,569)</u>
 Total Assets	 <u>\$ 21,163,229</u>	 <u>\$ 20,159,248</u>
 <u>Liabilities and Net Assets</u>		
Liabilities:		
Current Liabilities:		
Accounts Payable	\$ 3,252,926	\$ 1,235,161
Accounts Payable - USF	1,518,365	3,261,212
Salaries and Benefits Payable	162,351	150,159
Deferred Income - ITN	3,574,148	2,796,250
Deferred Income - Other	588,534	482,247
Capital Lease Payable - Current	1,099,635	646,753
IHETS Loan Payable	<u>450,000</u>	<u>-</u>
 Total Current Liabilities	 <u>10,645,959</u>	 <u>8,571,782</u>
 Noncurrent Liabilities:		
Capital Lease Payable - Long-Term	<u>611,524</u>	<u>379,550</u>
 Total Liabilities	 <u>11,257,483</u>	 <u>8,951,332</u>
 Net Assets		
Invested in Capital Assets, Net of Related Debt	275,070	801,128
Restricted for:		
State Technology Grants to Schools	8,806,507	5,720,901
State Technology Grants to Libraries	960,688	33,809
Other	509,567	645,949
Unrestricted (Deficit)	<u>(646,086)</u>	<u>4,006,129</u>
 Total Net Assets	 <u>9,905,746</u>	 <u>11,207,916</u>
 Total Liabilities and Net Assets	 <u>\$ 21,163,229</u>	 <u>\$ 20,159,248</u>

Intelenet Commission
Statement of Revenues, Expenses and Changes in Fund Net Assets
Years ended June 30, 2002 and 2003

	2002	2003
<u>Operating Revenue</u>		
Access Indiana - Information	\$ 17,367,412	\$ 19,427,787
Indiana Telecommunications Network	11,106,894	18,769,532
USF Revenues	1,533,191	5,167,934
Grant Revenues	3,500,000	3,416,936
Data	1,157,190	472,126
WAN Support Services	1,190,879	457,919
Long Distance Services	263,322	245,485
Lease Line	66,660	168,391
Equipments Sales	14,706	47,037
Indiana Web Academy	1,264,987	1,436,503
	<hr/>	<hr/>
Total Operating Revenues	37,465,241	49,609,650
	<hr/>	<hr/>
<u>Cost of Sales</u>		
Access Indiana - Information	17,823,728	19,079,422
Indiana Telecommunications Network	4,276,122	11,531,355
USF Expenses	2,239,266	5,167,934
Grant Expense - Connect 2000	4,331,690	7,429,421
Data	1,012,397	370,426
Equipment	111,366	153,348
Capital Lease Depreciation	1,148,805	1,073,707
Interest Expense on Capital Leases	71,446	68,302
Other Costs	4,595	57,377
Indiana Web Academy	1,123,462	1,300,121
	<hr/>	<hr/>
Total Cost of Sales	32,142,877	46,231,413
	<hr/>	<hr/>
Gross Income	5,322,364	3,378,237
	<hr/>	<hr/>
<u>Operating Expenses</u>		
Salaries	1,193,728	1,216,568
Employer Taxes and Benefits	403,551	390,823
Professional Services	309,349	285,197
Office Rent	138,755	147,510
Training and Travel	71,948	54,573
Depreciation	70,018	54,399
Other Operating Expenses	130,916	102,752
	<hr/>	<hr/>
Total Operating Expenses	2,318,265	2,251,822
	<hr/>	<hr/>
Net Operating Income (Loss)	3,004,099	1,126,415
	<hr/>	<hr/>
<u>Nonoperating Revenue (Expense)</u>		
Interest Income	331,298	175,755
	<hr/>	<hr/>
Change in Net Assets	3,335,397	1,302,170
	<hr/>	<hr/>
Net Assets, Beginning of Year (As Restated, 2002)	6,570,349	9,905,746
	<hr/>	<hr/>
Net Assets, End of Year	\$ 9,905,746	\$ 11,207,916
	<hr/>	<hr/>

Intelenet Commission
Statement of Cash Flows
For the year ended June 30, 2002 and 2003

	<u>2002</u>	<u>2003</u>
Cash flows from Operating Activities		
Receipts from Authorized Users	\$ 34,795,017	\$ 45,842,070
Payments to Suppliers	(30,888,679)	(46,025,454)
Payments to Employees	(1,591,865)	(1,620,583)
Net Cash provided by Operating Activities	<u>2,314,473</u>	<u>(1,803,967)</u>
Cash flows from Capital and Related Financing Activities		
Acquisition of Capital Assets	(818,940)	(969,308)
Net Cash from Capital Lease Financing	16,293	(684,856)
Proceeds from IHETS Loan	450,000	-
Payments on IHETS Loan	(4,826,980)	(450,000)
Net Cash Provided by Capital and Related Financing Activities	<u>(5,179,627)</u>	<u>(2,104,164)</u>
Cash Flows from Investing Activities		
Interest Income	<u>331,298</u>	<u>175,755</u>
Net decrease in Cash and Cash Equivalents	(2,533,856)	(3,732,376)
Cash and Cash Equivalents at Beginning of Year	<u>18,600,873</u>	<u>16,067,017</u>
Cash and Cash Equivalents at End of Year	<u>\$ 16,067,017</u>	<u>\$ 12,334,641</u>
Reconciliation of Operating Income to Net Cash		
Provided (Used) by Operating Activities:		
Operating Income	\$ 3,004,099	\$ 1,126,415
Adjustments to Reconcile Income to Net Cash		
Provided by Operating Activities:		
Depreciation Expense	1,218,823	1,128,106
Change in Assets and Liabilities:		
Accounts Receivable	(519,338)	108,961
Accounts Receivable - USF	301,141	(2,931,460)
Prepaid Expenses	(145,064)	(64,694)
Accounts Payable	1,502,583	(2,017,765)
Salaries Payable	2,707	(12,192)
Accounts Payable - USF	(743,515)	1,742,847
Deferred Income - ITN	2,354,340	(777,898)
Deferred Income - Other	(4,661,303)	(106,287)
Net Cash provided by Operating Activities	<u>\$ 2,314,473</u>	<u>\$ (1,803,967)</u>

INTELENET COMMISSION
NOTES TO COMPONENT UNIT FINANCIAL STATEMENTS
June 30, 2003

I. Summary of Significant Accounting Policies

- A. Reporting Entity - The Intelenet Commission is a body corporate and politic created under Indiana Code 5-21-1 enacted by the General Assembly of the State of Indiana. The Intelenet Commission was set up to establish a statewide integrated telecommunications network that economically, efficiently, and effectively meets the needs of authorized users to telecommunicate documents, pictures, data, sounds or other symbols from place to place.

Accounting principles generally accepted in the United States require that these financial statements present the Intelenet Commission (primary government) and its significant component units. There are no significant component units which require inclusion.

- B. Measurement Focus, Basis of Accounting and Financial Statement Presentation - The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Intelenet Commission distinguishes operating revenues from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with Intelenet's principal ongoing operations. The principal operating revenues are charges to customers for sales and services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The primary government has elected not to follow subsequent private-sector guidance.

C. Assets, Liabilities and Net Assets or Equity

1. Deposits and Investments - Cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition. Cash and cash equivalents are stated at cost, which approximates fair value.

The cash balance is maintained in general checking accounts and a money market bank account. The available cash balance not necessary beyond immediate need is invested in the money market account. In addition to these accounts, the Intelenet Commission purchases certificates of deposits. Interest from the certificates is received monthly.

The deposits with financial institutions at year-end were entirely insured by federal depository insurance or by the Indiana Public Deposit Fund. This includes any deposit accounts issued or offered by a qualifying institution.

INTELENET COMMISSION
NOTES TO COMPONENT UNIT FINANCIAL STATEMENTS
June 30, 2003
(Continued)

2. Capital Assets - Capital assets are reported at actual or estimated historical cost based on appraisals or deflated current replacement cost. Contributed or donated assets are reported at estimated fair value at the time received.

Capitalization thresholds (the dollar values above which asset acquisitions are added to the capital asset accounts), depreciation methods and estimated useful lives of capital assets reported in the government-wide statements and proprietary funds are as follows:

	Capitalization Threshold	Depreciation Method	Estimated Useful Life
Furniture and fixtures	\$ 1,000	Straight-line	3
Computer equipment	1,000	Straight-line	3
Leasehold improvements	1,000	Straight-line	3
Capital lease equipment	1,000	Straight-line	4
Telecom equipment: multiplexors	1,000	Straight-line	3
Other telephone equipment	1,000	Straight-line	3

3. Deferred Income - Liabilities for deferred income are maintained for payments received by the Intelenet Commission in advance of the service provided. Upon providing the services, the income is recognized. Deferred grant income liabilities are advances received for grants containing repayment provisions.
4. Restricted Net Assets - Certain net assets are classified as restricted net assets because their use is completely restricted by bond indentures, contracts, grantors, contributors, laws or regulations of other governments, or through constitutional provisions or enabling legislation.

Restricted for State Technology Grants to Schools - established to recognize balances retained for the purposes specified in Indiana Code 4-34-3-4.

Restricted for State Technology Grants to Libraries - established to recognize balances retained for the purposes specified in Indiana Code 4-34-3-2

II. Detailed Notes on All Funds

A. Deposits and Investments

Deposits, made in accordance with Indiana Code 5-13, with financial institutions in the State of Indiana at year end were entirely insured by the Federal Depository Insurance Corporation or by the Indiana Public Deposit Insurance Fund. This includes any deposit accounts issued or offered by a qualifying financial institution.

B. Capital Assets

Capital asset activity for the fiscal years ended, were as follows:

INTELENET COMMISSION
NOTES TO COMPONENT UNIT FINANCIAL STATEMENTS
June 30, 2003
(Continued)

<u>Fiscal Year 2001-2002</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
<u>Business-type activities</u>				
Capital assets, being depreciated:				
Machinery and equipment	\$ 5,400,752	\$ 818,940	\$ -	\$ 6,219,692
Less accumulated depreciation for:				
Machinery and equipment	<u>3,014,640</u>	<u>1,218,823</u>	<u>-</u>	<u>\$ 4,233,463</u>
Total business-type capital assets, being depreciated, net	<u>\$ 2,386,112</u>	<u>\$ (399,883)</u>	<u>\$ -</u>	<u>\$ 1,986,229</u>
 <u>Fiscal Year 2002-2003</u>				
<u>Business-type activities</u>				
Capital assets, being depreciated:				
Machinery and equipment	\$ 6,219,692	\$ 969,308	\$ -	\$ 7,189,000
Less accumulated depreciation for:				
Machinery and equipment	<u>4,233,463</u>	<u>1,128,106</u>	<u>-</u>	<u>\$ 5,361,569</u>
Total business-type capital assets, being depreciated, net	<u>\$ 1,986,229</u>	<u>\$ (158,798)</u>	<u>\$ -</u>	<u>\$ 1,827,431</u>

C. Leases

1. Operating Leases

The Commission has entered into an operating lease having initial or remaining noncancelable terms exceeding one year for the lease of its facilities. Rental expenditures for this lease for the years 2002 and 2003 were \$138,755 and \$147,510 respectively. The following is a schedule by years of future minimum rental payments as of June 30, 2003:

2004	\$ 250,974
2005	134,857
2006	112,694
2007	<u>42,457</u>
Total	<u>\$ 540,982</u>

INTELENET COMMISSION
NOTES TO COMPONENT UNIT FINANCIAL STATEMENTS
June 30, 2003
(Continued)

2. Capital Leases

The primary government has entered into various capital leases for an equipment procurement contract and master capital lease agreement in 1998 for telecommunications switching equipment and other equipment for the statewide backbone network. Future minimum lease payments and present values of the net minimum lease payments under these capital leases as of June 30, 2003, are as follows:

2004	\$ 696,689
2005	381,404
2006	<u>5,887</u>
Total minimum lease payments	1,083,980
Less amount representing interest	<u>57,677</u>
Present value of net minimum lease payments	<u>\$ 1,026,303</u>

Assets acquired through capital leases still in effect are as follows:

Property and equipment	\$ 4,923,423
Accumulated amortization	<u>(3,710,734)</u>
Total	<u>\$ 1,212,689</u>

D. Long-Term Obligations

Changes in Long-Term Obligations

	Balance July 1	Increase	Decrease	Balance June 30	Amounts Due Within One Year	Amounts Due Thereafter
2001-2002:						
Capital Leases	<u>\$ 1,612,454</u>	<u>\$ 711,541</u>	<u>\$ (612,836)</u>	<u>\$ 1,711,159</u>	<u>\$ 1,099,635</u>	<u>\$ 611,524</u>
2002-2003:						
Capital Leases	<u>\$ 1,711,159</u>	<u>\$ 414,991</u>	<u>\$ (1,099,847)</u>	<u>\$ 1,026,303</u>	<u>\$ 646,753</u>	<u>\$ 379,550</u>

INTELENET COMMISSION
NOTES TO COMPONENT UNIT FINANCIAL STATEMENTS
June 30, 2003
(Continued)

III. Other Information

A. Access Indiana Information Revenue

This revenue is reported as received by the Intelenet Commission from the contracted network manager. In accordance with the contract, Intelenet receives two percent of the gross revenues from both the fees established by the Enhanced Data Access Review Committee per Indiana Code 5-21-6-4, and from the fees required to be collected for the state agencies whose information is accessed. The contractor must remit the state agencies' fees and then has the balance of the enhanced access fees for the operation costs and profit. A contract provision allows Intelenet to direct up to twenty five percent of the contractor's expenses.

B. Net Grant Revenue

Grants of state and non-state funds are not reflected in the financial statements. The Commission received state grants for Internet grants for schools and public libraries, associated projects, and implementing the State Backbone Network. The Commission also received funds from the universal service discounts entitlement program administered by the United States Federal Communication Commission. The non-expended balances of refundable grants are shown as deferred grant income. The balance of the universal service discounts reimbursed is payable to, or on the behalf of, the public schools and libraries. The balance of nonrefundable state grants is restricted reserves.

C. Universal Service Funds

In accordance with Indiana Code 201-0.1-25.6-3, Intelenet serves as the administrator to coordinate the public schools and libraries Internet access rate reductions provided by the federal Universal Service Discount program. The Schools and Libraries Universal Service program was established as part of the FCC Telecommunications Act of 1996 to provide affordable telecommunications services for all eligible schools and libraries, especially those in rural and economically disadvantaged areas.

USF Accounts receivable and related revenues have been recorded for amounts due to Intelenet during the fiscal year. In addition, USF Accounts payable and related expenses are recorded for amounts due to the schools and libraries at year-end.

D. Business Relationship with Indiana Higher Education Telecommunications System (IHETS)

The IHETS executive director is an Intelenet Commission member in accordance with Indiana Code 5-21-2-3(a)(9). The Intelenet Commission has provided voice, video, and data network services to IHETS since 1987. During 1997, IHETS began serving as an operational agent and network manager for the Intelenet Commission's internet services to schools and libraries. IHETS reimbursed Intelenet for the direct supplier costs of sales it incurred, and billed Intelenet its total costs as itemized for each customer. Intelenet then billed the customers. In conjunction with these services, Intelenet provided the capital lease equipment to IHETS, with IHETS reimbursing the monthly lease payments.

INTELENET COMMISSION
NOTES TO COMPONENT UNIT FINANCIAL STATEMENTS
June 30, 2003
(Continued)

E. Risk Management

The Intelenet Commission is exposed to various risks of loss. This includes damage to property owned, personal injury, or property damage liabilities incurred by agents or employees, errors, omissions and theft by employees, certain employee health, disability, and death benefits, and worker's compensation costs for Commission employees. The Intelenet Commission maintains commercial insurance coverage for the above, except for certain employee health, disability and death benefits, which are administered by the state. The Commission pays the state at the rates it has determined for these coverages, and thereby fully transfers the associated risks. Settlements related to commercial insurance have not exceeded coverage in the past three fiscal years.

F. Employee Retirement System

Plan Description: The Intelenet Commission contributes to the Indiana Public Employees' Retirement Fund (PERF). PERF is a defined benefit agent multiple-employer plan administered by the Public Employees' Retirement Fund Board of Trustees. PERF provides retirement, disability retirement and survivor benefits. Indiana Code 5-10.2 and 5-10.3 governs the requirements of the Fund. The Public Employees' Retirement Fund Board of Trustees issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole. The report may be obtained by writing the Public Employees' Retirement Fund, Rm. 800, 143 West Market Street, Indianapolis, IN 46204.

Funding Policy The State of Indiana and any political subdivision that elects to participate in the PERF fund is obligated by statute to make contributions to the plan. The required employer contributions are determined by the Board of Trustees based on actuarial investigation and valuation. PERF funding policy provides for periodic employer contributions at actuarially determined rates, that, expressed as a percentage of annual covered payroll, are sufficient to fund the pension portion of the retirement benefit (normal cost), administrative expenses, and anticipated increase in the unfunded actuarial accrued liability for the next fiscal year, as well as amortization of the initial prior service cost.

Contributions made on the behalf of members are not actuarially determined but are set by statute at three percent (3%) of wages. These contributions are credited to the member's annuity savings account that funds the annuity portion of the retirement benefit.

The Intelenet Commission is required to contribute for its employees at the actuarially determined rate for the State of Indiana and its component units. The current rate is 5.5% of covered payroll. All required disclosures under GASB can be found in the State's CAFR.

G. IHETS Loan Payable

As part of Intelenet's project of building of the Indiana Telecommunication Network (ITN), Intelenet entered into an agreement to borrow \$4,836,175 from IHETS during FY 2001. An additional \$450,000 was borrowed during FY 2002. These agreements were for short term financing of ITN development costs until other funds were made available to cover anticipated costs of ITN development. The balance at June 30, 2002, was \$450,000 and \$0 at June 30, 2003.

INTELENET COMMISSION
NOTES TO COMPONENT UNIT FINANCIAL STATEMENTS
June 30, 2003
(Continued)

H. Prior Period Adjustment

Intelenet made prior period adjustments totaling \$6,055,938 to recognize liabilities for IHETS loan payable (\$4,836,175) and Deferred Income – ITN (\$1,219,808) at June 30, 2001. Therefore, Net Assets at Beginning of Year 2002 was reduced by \$6,055,983 to reflect the proper amount.

June 30, 2001, net assets as reported	\$ 12,626,332
Prior period asset:	
Correction of error	<u>6,055,983</u>
Balance July 1, 2001, as restated	<u>\$ 6,570,349</u>

INTELENET COMMISSION
AUDIT RESULTS AND COMMENTS
June 30, 2003

CAPITAL ASSET DEPRECIATION

The Peachtree software that Intelenet uses to record the financial transactions of the agency does not always use the correct start date to calculate the capital asset depreciation properly. The agency's policy is to allocate depreciation for each asset the first day of the following month it is acquired.

For assets tested during the audit period, thirteen out of twenty-five assets tested had an incorrect year to date depreciation expense calculation or the accumulated depreciation amount was incorrect. The amounts of the differences were usually for one month's depreciation. It was determined there is a glitch in the software that calculates the depreciation. When the asset is first keyed into the system it may not calculate the depreciation by the date purchased, but rather the date it was keyed into the system. The accountant does not check to verify the depreciation is being calculated properly according to their policy by using the correct starting date.

Each agency, department, institution or office has the responsibility to comply with their own internal policies and guidelines. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

INTELENET COMMISSION
EXIT CONFERENCE

The contents of this report were discussed on June 2, 2004, with Mr. Stanley G. Jones, Chairman of the Commission; Mr. G. Kent Champagne, Jr., Interim Executive Director; Mr. Clement Bello, Accountant; Mr. Ken Scales, Director of Web Academy; and Mr. Terry Bradshaw, Network Financial Manager. The official response has been made a part of this report and may be found on Pages 23 and 24.

June 8, 2004

State Board of Accounts
Room E418, IGC South
302 W. Washington St.
Indianapolis, IN 46204

The following audit results and comments were presented to Intelenet Commission management in an audit exit conference conducted in the Commission for Higher Education offices on June 2, 2004. Included is Intelenet's formal response to the audit results and comments.

INTELENET COMMISSION
Audit Results and Comments
June 30, 2003

Capital Asset Depreciation

The Peachtree software that Intelenet uses to record the financial transactions of the Agency does not always use the correct start date to calculate the capital asset depreciation properly. The agency's policy is to allocate depreciation for each asset the first day of the following month it is acquired.

For assets tested during the audit period, 13 out of 25 assets tested had an incorrect year to date depreciation expense calculated or the accumulated depreciation amount was incorrect. The amounts of the differences were usually for one month's depreciation. It was determined there is a glitch in the software that calculates the depreciation. When the asset is first keyed into the system it may not calculate the depreciation by the date purchased, but rather the date it was keyed into the system. The accountant does not check to verify the depreciation is being calculated properly according to their policy by using the correct starting date.

Each agency, department, institution or office has the responsibility to comply with their own internal policies and guidelines. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1).

Intelenet Response

The Intelenet Commission accounting team will adhere to its own depreciation policy which proscribes beginning of the month timing for depreciation entries within its fixed asset module. Intelenet management will monitor procedures to ensure that the purchase date is recognized in establishing the start date for depreciation. The Intelenet Commission will start depreciation on the first day of the month that the asset was purchased, not the following month, and will consistently adhere to this procedure.

The Intelenet Commission has recently procured a new fixed asset accounting system module (FAS Module) from Peachtree's new owner, Best Software. It is expected that this new software package will improve the mechanized depreciation accounting processes. The Intelenet Commission will also make adjustments as needed to the start dates for the 13 items noted above.

Signed: G. Kent Chappin Jr.

Interim Executive Director